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SUBJECT: THE BAHRAIN BANKING SECTOR 2009: A PRIMER

¶11. Summary: Bahrain hosts 412 diverse financial institutions ranging from local lenders to large-scale project finance investment banks.

Supported mostly on the back of petrodollars, this sector has grown to become the largest contributor to the Bahraini economy. This cable outlines the banking sector as a whole, and describes the major players within each of the three main subsectors: wholesale (offshore) banking, retail (commercial) banking, and Islamic banking. End Summary

Traditional Banking

¶12. Bahrain has long been the financial conduit for the petrodollars of its GCC neighbors. In order of importance, Saudi Arabia, Kuwait, Qatar, and the UAE, account for the overwhelming majority of banking assets in Bahrain. Several of the major banks are owned either directly or indirectly by the governments of these countries.

¶13. The Bahraini banking sector is comprised of 61 wholesale (offshore) banks, 42 investment banks, and 28 retail (commercial) banks, of which 26 are foreign owned. According the Central Bank of Bahrain (CBB), at the end of Q1 2009, the traditional banking system (not including Islamic finance) had a consolidated balance sheet of \$243.9 billion. Almost three-quarters of this total was accounted for by the wholesale sector at \$179.9 billion, while the retail sector added \$64 billion. Total Domestic Assets equaled \$51.2 billion, while total foreign liabilities reached \$187.4 billion, or more than eight times the annual GDP of Bahrain. The total equity of the banking sector was \$24.1 billion.

Islamic Banking

¶14. The Government of Bahrain (GOB) has identified Islamic banking as one of the main economic growth areas in the coming five years. Islamic banking principles are similar to those of conventional banking, with the exception that Islamic banks must conform to Shari'ah, or Islamic law. Islamic finance prohibits charging interest for the use of money, and disallows dealing in certain commodities. Islamic banking falls under four main categories:

--Murabaha: cost-plus financing - i.e., buying a product from a supplier and selling it to a customer for a profit;
--Musharraka: a profit sharing system that is similar to equity participation;
--Ijara: leasing; and
--Istisna: the financing of construction or manufacturing.

¶15. Islamic banking attracts investors because of its profit potential, as well as its religious and ethical approach. While the sector is still small, it has registered strong continual growth despite regional uncertainties that hindered growth in conventional banking. At the end of Q1 2009, the Islamic sector had \$24.6 billion in total assets.

¶16. Islamic banking became an engine of growth for Bahrain and continues to attract high net-worth individual investors from GCC countries. This sector has grown by an average of 21 percent over

the past three years. The Crown Prince and other government officials have voiced Bahrain's commitment to developing the sector further.

Regulatory Environment

¶ 17. In 2006, the Bahrain Monetary Agency (BMA) transformed into the Central Bank of Bahrain (CBB). The CBB regulates the banking sector under the provisions of the BMA law (Decree Law No. 23 of 1973). In May 2002, the Government of Bahrain announced that regulatory responsibility for the insurance sector and stock exchange would move to the BMA (now CBB). Seeking to maintain Bahrain's status as the Gulf region's preeminent financial center, the CBB changed its licensing practices in 2006 to give banks greater opportunities to invest domestically and regionally. The CBB has been active in developing regulations for the Islamic banking sector, and has been instrumental in making Bahrain a recognized center of Islamic banking. The Central Bank has fully implemented Basel II standards for both the traditional and Islamic banking sectors.

The Top Three Retail (Commercial) Banks

¶ 18. Ahli United Bank -- Ahli United is the largest publically traded commercial lender in Bahrain. Major stake-holders include Ahmed Al Kharaffi (Kuwait), and various members of the Kuwaiti Royal family. Ahli United holds a 25% share of Alliance Housing Bank, and major stakes in Future Bank (Iran), Bank of Kuwait & the Middle East, Qatar Ahli Bank, and the Commercial Bank of Iraq. In January 2009

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it reported a market capitalization of more than \$6 billion. Under CEO Adel El Labban, Ahli United is licensed by the CBB for commercial, wholesale, investment and private banking, and fund management.

¶ 19. National Bank of Bahrain (NBB) -- Established by the government in 1956, NBB has the largest number of outlets in Bahrain (currently 28). Through its quasi-sovereign wealth fund Bahrain Mumtalakat Holding, the government still owns a 50% share of the bank. At the end of Q1 2009, NBB reported a market capitalization of approximately \$2 billion. NBB's CEO is Abdul Razak Qassim, a Bahraini, and it is licensed as a commercial bank only.

¶ 10. BBK (formerly Bank of Bahrain & Kuwait) -- BBK was established in 1971, and has 21 branches in Bahrain. Although publicly traded, Ithmaar Bank and Kuwait Global Investment combined own approximately a 45% share of BBK. Its market capitalization is approximately \$1.5 billion, and is most well known as the Bahraini bank that had the largest direct exposure to sub-prime mortgage instruments, directly resulting in the resignation of long-time CEO Fareed Al Mullah. Mullah was replaced by Abdul Karim Buheeri. It is licensed as a commercial bank only.

The Top Three Wholesale (Offshore) Banks

¶ 11. Gulf International Bank (GIB) -- GIB was originally set up by the GCC member states, with each state holding an equal share. After years of poor risk management and significant losses, the original owners have sold off their stakes, with the Saudi government buying up shares. Today the primary stake holder is the Saudi Monetary Authority with a 67.5% share, followed by the Saudi Public Investment Fund at 29.7%. The remaining 2.8% is held by the original partners: Kuwait Investment Authority--0.73%; Qatar Investment Authority-- 0.73%; Bahrain Mumtalakat--0.44%; Oman Ministry of Finance-- 0.44%; and the UAE Ministry of Finance--0.44%. GIB has a stated focus on the oil and gas sector, but is known to have had significant exposure to financial crisis, and has needed to be re-capitalized twice. Since 2007, total losses have exceeded \$1.5 billion. Top management is all Saudi, including CEO Yahya Al Yahya.

¶12. Arab Banking Corporation (ABC) -- Established 1980, ABC is owned in almost equal shares by three countries: Kuwait Investment Authority -- 29.7%, the Central Bank of Libya -- 29.5%, and the Abu Dhabi Investment Authority-- 27.6%. A variety of other shareholders hold the remaining 13.2%. ABC's market capitalization was around \$2 billion at the end of 2008, and losses since 2007 are believed to be nearly \$1 billion. CEO and President, Hassan Ali Juma, used to be the CEO of NBB.

¶13. United Gulf Bank (UGB) -- UGB is the investment banking arm of Kuwait Projects Company (KIPCO). With a market capitalization of \$1.6 billion, it operates in 11 NEA countries. Headquartered in Bahrain, it is licensed as a wholesale bank only. Both management and investors are known to have close ties to the Kuwaiti royal family. Long-time Amcit CEO William Khoury resigned in June 2008 and has not yet been replaced.

The Top Three Islamic Banks

¶14. Gulf Finance House -- Gulf Finance House is one of the best-diversified of all the Islamic banks, with holdings and investments in every major sector. Its CEO, Essam Janahi, has recently entered into three major Islamic finance ventures with Ithmaar Bank (headed by his brother Khalid Janahi) and Abu Dhabi Investment House (led by his brother Rashaad Janahi): InfraCapital, AgriCapital, and the Hospitality Development Fund. GFH's market cap exceeds \$3.1 billion, and it has major real-estate holdings throughout the region - one residential project in Bahrain contains 30,000 units valued at \$3.2 billion. Gulf Finance House also runs and operates a stand-alone commercial unit under the name Khaleej Finance House.

¶15. - Al-Baraka Islamic Bank -- A subsidiary of Lebanon-based Al Baraka Group, Al Baraka Islamic has a market cap of almost \$1.7 billion. One of the most successful banks in 2008, it announced a net income increase of 62% in 2008. In March 2009, it announced plans to expand into South Asia and Indonesia. Primarily a wholesale operation, Al Baraka also operates a commercial unit in Bahrain. One of the most prominent stakeholders is Sheikh Salah Kamel from the Western Province of Saudi Arabia.

¶16. Arcapita -- Arcapita is a well-diversified, international Islamic bank with significant holdings in the U.S. Arcapita maintains offices in Bahrain, Atlanta, London, and Singapore. The bank has a paid-in capital of \$282 million, of which approximately 67% is held by some 270 prominent individuals, including Saudi national Mohammed Abdulaziz Al Jumaih, one of the wealthiest

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billionaires in the world, along with numerous investors from both the Qatari and Saudi royal families. The remaining 33% is beneficially held by Arcapita's management. Arcapita has net assets totaling \$5.1 billion and an equity capital base of \$1.4 billion. Arcapita focuses on business investment, corporate investment, real estate investment, and asset-based investment and venture capital.

Rising Stars

¶17. Ithmaar Bank (Traditional) -- Ithmaar Bank, incorporated as a small subsidiary of Shamil Bank in 1984, has grown significantly, purchasing major stakes in a variety of other banks and investment houses including once-parent company Shamil Bank, BBK, SAKANA Mortgage, First Leasing Bank, and Solidarity Insurance. Headed by Khalid Janahi, brother of Gulf Finance House giant Essam Janahi, Ithmaar Bank was one of the few banks to report profits every quarter throughout 2007-2008. Ithmaar bank recently spun off a wholly-owned subsidiary, Ithmaar Development Company, to handle major real estate development projects throughout the region, including Dilmunia Health Care Island in Bahrain.

¶18. Unicorn Bank (Islamic) -- Founded in 2004, Unicorn Investment

Bank (Unicorn) is an Islamic investment bank with an international presence in the United States, Malaysia, the UAE, Turkey, and Pakistan. Unicorn's stated goal is to become the leading global provider of Shari'ah-compliant investment banking products and services. Unicorn has developed its business model around six core business lines: Capital Markets, Private Equity, Corporate Finance, Asset Management & Real Estate, Strategic Mergers & Acquisitions, and Treasury. Unicorn's U.S. office is located in Chicago.

¶19. Istiklaf Bank (Islamic) -- Istiklaf Bank, set to open in the fall of 2009, aims to be the largest Islamic Bank in Bahrain with a target opening capitalization of \$5 billion. Istiklaf is a new subsidiary of the Al Baraka Group (parent company of Al Baraka Islamic Bank), and rumor has it that its initial investors are primarily from Saudi Arabia's Western Province.

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